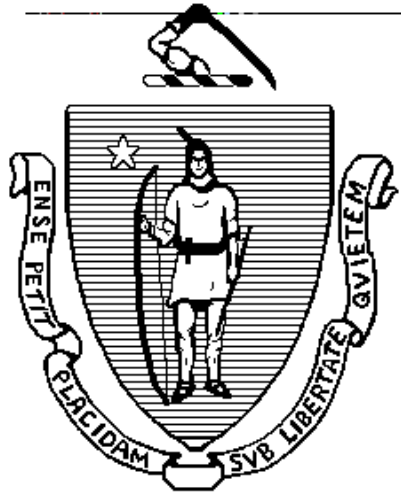


# Commonwealth of Massachusetts



## Comprehensive Annual Financial Report

*For the Fiscal Year Ended June 30, 1996*

William Kilmartin, *CGFM*  
*State Comptroller*

Prepared by  
*The Financial Reporting and Analysis Bureau*  
*Office of the State Comptroller*

This document and related information are available via the Office of the Comptroller's home page:  
<http://www.state.ma.us/osc/osc.htm>

Front and back cover artwork:  
*Starting line of the 100th running of the Boston marathon.*

Watercolor by:  
*Nancy C. Bailey*

Courtesy of:  
*The Hopkinton Athletic Association*

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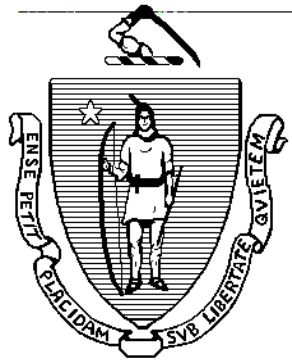
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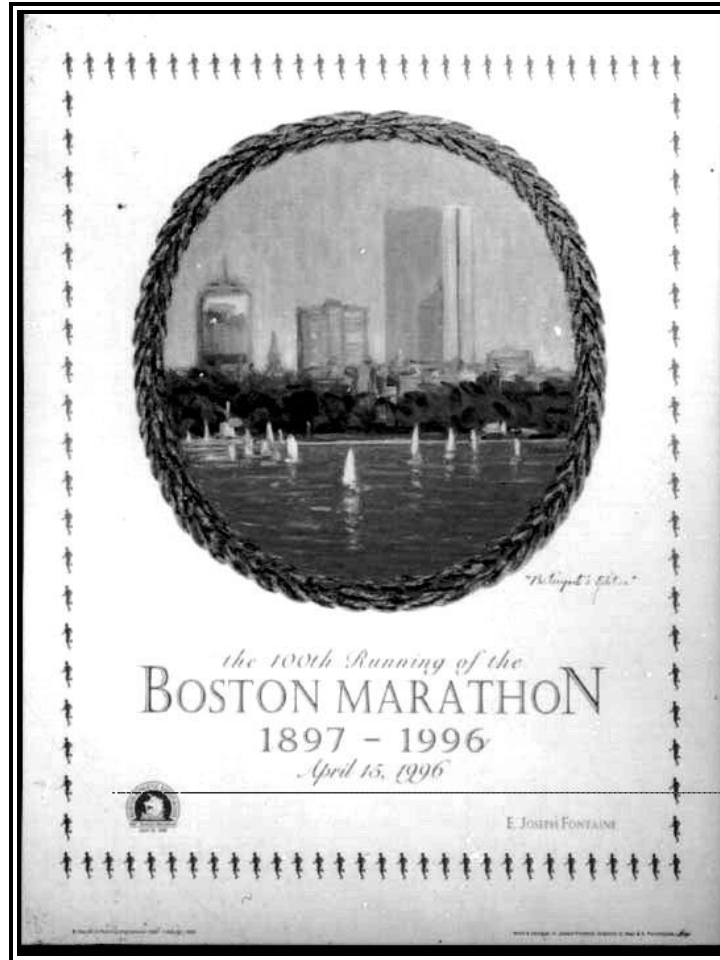
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# *Introductory Section*



*Official Poster of the 100th running of the Boston Marathon*

*Comptroller's Letter of Transmittal*  
*List of Principal State Officials*  
*Organization of State Government*  
*Acknowledgments*  
*Certificate of Achievement*

# *The Commonwealth of Massachusetts*

*Office of the Comptroller*

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WILLIAM KILMARTIN  
COMPTROLLER

Phone (617) 727-5000  
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December 20, 1996

***To the Citizens of the Commonwealth of Massachusetts,  
Governor William F. Weld, and Honorable Members of the General Court:***

It is with great pleasure that I transmit the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 1996 (FY96). The cover and artwork in this document celebrate the 100 year anniversary running of the Boston Marathon. While this is only the 11th time we have reported the Commonwealth's Financial results in accordance with generally accepted accounting principles (GAAP), I am pleased to report that the financial condition of the Commonwealth is excellent. For the sixth consecutive year revenues have exceeded expenditures by a significant amount. It was not long ago, in FY90, that the Commonwealth reported in the Budgeted Funds a historic GAAP deficit balance of \$1.9 billion. We now report a positive GAAP balance in these funds of \$709.2 million. Six years of prudent fiscal management, characterized by structurally balanced budgets, combined with a favorable economy, have caused this turnaround. The Commonwealth's strategic reserve, called the Stabilization Fund, is now funded to its statutory maximum of \$543.3 million. The additional amount of \$231.7 million has been reserved for income tax reduction in FY97 and the future. In FY90 and FY91, the Commonwealth resorted to over \$1.8 billion in deficit borrowing. In FY97 each individual taxpayer will receive a tax reduction of approximately \$43, and the deficit borrowing will be completely repaid in early FY98. The ongoing challenge to state policy makers is to sustain this excellent financial condition.

The Office of the Comptroller is responsible for the fair presentation of the financial statements of the Commonwealth and for the preparation of this Comprehensive Annual Financial Report which is presented in three sections: Introductory, Financial, and Statistical. The three sections of the CAFR, as detailed in the table of contents, include the information necessary for the reader to obtain a comprehensive understanding of the Commonwealth's financial position and the results of its operations for FY96.

The CAFR is prepared in accordance with GAAP as established by the Governmental Accounting Standards Board (GASB), the professional standards of the American Institute of Certified Public Accountants (AICPA), the recommendations of the Government Finance Officers Association (GFOA), and the requirements of state finance law.

In FY96 the Commonwealth implemented three new GASB statements. One of these statements, while effective for FY96, did not materially change the CAFR presentation. This statement is:

- Statement No. 24 Accounting and Reporting for Certain Grants and Other Financial Assistance.

However, two GASB statements engendered a material change on the FY96 CAFR as follows:

- Statement No. 25 Financial Reporting for Defined Benefit Pension Plans and Note Disclosure for Defined Contribution Plans; and
- Statement No. 27 Accounting for Pensions by State and Local Governmental Employers.

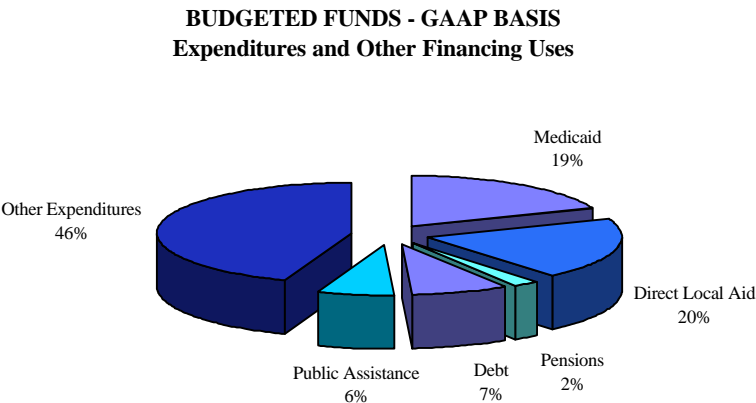
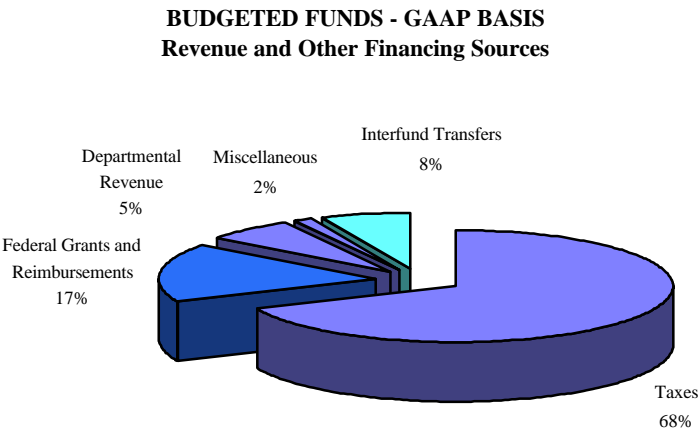


The financial statements and note disclosures which follow have been changed to conform to the new GAAP requirements. The measurement focus of the new GAAP is to determine if current contributions do or do not satisfy the requirements of a rational and systematic actuarial funding plan. As the reader will see, the Commonwealth met this test in FY96. Under the prior GAAP, the Commonwealth's actuarial funding plan which extends over 40 years, did not meet the standard which was 25 years, so that amounts were accrued and reported in the General Long-Term Debt Account Group and the Commonwealth reported an unfunded pension liability. Under the new GAAP these amounts are removed. The accounting change does not mean the Commonwealth can forego its pension funding plan which has been implemented since its creation in FY88. Simply stated, the accounting principles now focus on the faithful annual adherence to such plan.

**BUDGETED FUNDS OPERATIONS**

The portion of state finances that typically engenders the highest degree of interest is the Budgeted Funds. These include the General, Local Aid, Highway, and Other Special Revenue Funds which comprise the annual state budget.

In FY96, revenues and other financing sources totaled \$17,524.6 million. The chart below shows the percentage of revenue by type contributing to that total. Budgeted Funds expenditures and other financing uses totaled \$17,102.8 million in FY96. The chart below depicts the percentage of each major program in this total.



**Budgeted Funds Operations - GAAP Basis**  
(Amounts in millions)

	FY92	FY93 <sup>(1)</sup>	FY94	FY95	FY96
Beginning fund balances (deficits).....	\$ (761.2)	\$ (317.4)	\$ (184.1)	\$ (72.0)	\$ 287.4
Equity transfer .....	-	-	-	91.0	-
Restated beginning balances (deficits).....	(761.2)	(317.4)	(184.1)	19.0	287.4
Revenues and other financing sources.....	14,129.7	15,181.0	15,804.9	16,517.5	17,524.6
Expenditures and other financing uses.....	13,765.9	15,047.7	15,692.8	16,249.1	17,102.8
Excess.....	363.8	133.3	112.1	268.4	421.8
Ending fund balances (deficits).....	\$ (397.4)	\$ (184.1)	\$ (72.0)	\$ 287.4	\$ 709.2

(1) As restated to reflect discrete presentation of the University and College Fund.

**Budgeted Funds Operations - Statutory Basis**  
(Amounts in millions)

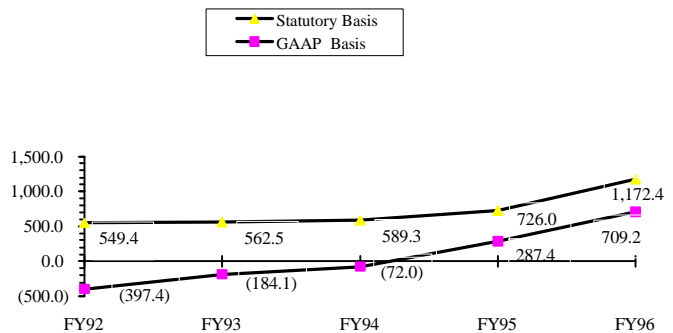
	FY92	FY93	FY94	FY95	FY96
Beginning fund balances.....	\$ 237.1	\$ 549.4	\$ 562.5	\$ 589.3	\$ 726.0
Revenues and other financing sources.....	14,226.1	15,205.7	15,979.2	16,930.8	18,371.3
Expenditures and other financing uses.....	13,913.8	15,192.6	15,952.4	16,794.1	17,924.9
Excess.....	312.3	13.1	26.8	136.7	446.4
Ending fund balances.....	\$ 549.4	\$ 562.5	\$ 589.3	\$ 726.0	\$ 1,172.4

The tables above set forth a multi-fiscal year view of financial performance for the Budgeted Funds under GAAP, and also provide a comparison to the same funds as accounted and reported under the statutory basis of accounting.

On the statutory basis of accounting, which is used to develop the Commonwealth's budget and control its daily activities, the Budgeted Funds have achieved positive ending fund balances for each of the years, increasing this fund balance from \$549.4 million to \$1,172.4 million for a cumulative improvement of \$623.0 million.

Over the same period on a GAAP basis, operating gains have improved fund balance from a deficit \$397.4 million to a positive \$709.2 million, with cumulative improvement of \$1,106.6 million. Simply stated, the widely acknowledged efforts to accomplish fiscal balance on a statutory basis are even more impressive when viewed on a GAAP basis.

**Trends in Fund Balance**  
(Amounts in millions)



The basic principle of GAAP is to match inflows pertaining to the fiscal year to outflows for the same period in order to demonstrate if the objective of interperiod equity has been accomplished. A modified accrual basis of accounting is employed to recognize certain assets and liabilities. Accomplishment of interperiod equity is denoted by an increase in fund balance, and the failure to accomplish that goal is denoted by a decrease in fund balance. The effect of fund deficits shifts the burden of funding expenditures incurred in prior years to taxpayers in future years. The Commonwealth has provided not only revenues to match expenditures in the current year, but also excess revenues to “catch up” on prior year deficits.

There are five major items that account for almost all the difference between the statutory basis reporting and GAAP: Medicaid, subsidies to authorities, compensated absences, claims and judgments, and tax revenues.

For the Medicaid program, expenditures under the statutory basis of accounting are equivalent to cash disbursements. Thus bills for services rendered in the fiscal year but not paid, or rate adjustments owed but not paid, are not measured in that year, but “pushed” into the next fiscal year. Under GAAP, such items are accrued, so that all expenditures are consistently correlated to the fiscal year to which they pertain. The Medicaid expenditures measured on a GAAP basis for FY96 were \$3,241.1 million, which is 0.3% lower than FY95. This very small decrease is noteworthy, since total budgeted expenditures increased 3.9% from FY95 to FY96. It is apparent that initiatives implemented by the Division of Medical Assistance are constraining Medicaid growth to amounts less than the total budget, thus helping to balance the overall budget.

A second item is the amount the Commonwealth will owe for subsidies to the Massachusetts Bay Transportation Authority (MBTA), the Regional Transit Authorities (RTAs), and the Massachusetts Convention Center Authority. Through various laws the Commonwealth has obligated itself to provide subsidies to these component units for operations and debt service.

However, the annual budget is appropriated on a basis which “lags” behind the total amount of the subsidy. Under GAAP, this amount is accrued, so that the total obligation is measured. For many years the amount for the “not yet appropriated” subsidy was growing at rates higher than the total budget. However, in recent years this trend has reversed, and in FY96 the amount accrued for MBTA subsidy obligations not yet appropriated decreased from FY95 by \$71.0 million. A special commission, chaired by the Secretary of Administration and Finance and with 12 entities represented, has been formed to study and make recommendations to the Legislature on matters relating to the MBTA subsidy.

The third item is compensated absences. Under GAAP, the amounts owed for vacation earned but not yet taken and certain amounts of sick leave are accrued and reported as expenditures of the fiscal year. The trend for compensated absences has been relatively consistent.

The fourth item is claims and judgments. Under the statutory basis, amounts owed in lawsuits for torts, tax disputes, eminent domain land taking, or other legal actions are not measured as expenditures until the lawsuit is decided and the settlement is actually paid. Under the GAAP basis, an analysis is performed on all litigation, and an amount is accrued for that portion of litigation where a settlement against the Commonwealth is considered probable. With efforts by the Office of the Attorney General to resolve litigation in a successful and timely manner, the amount of this accrual has been gradually decreasing.

The fifth item that explains the difference between statutory and GAAP relates to tax revenue. For several reasons, as an example the extension of an income tax return, a taxpayer’s obligation incurred in a fiscal year might not be fully collected until the ensuing fiscal year. Under GAAP, a special analysis is conducted in conjunction with the Department of Revenue (DOR), and an accrual for revenue is computed. The value of accrued revenue was \$371.8 million in FY96.

## GOVERNMENTAL FUND OPERATIONS

The Government Fund Type includes all funds where the Commonwealth imposes its sovereign authority to create revenues and authorize expenditures. This includes all Budgeted Funds as previously described (General and several Special Revenue Funds), all other (non-budgeted) Special Revenue Funds, and the Capital Project Funds. When viewed as a whole, these funds portray the Commonwealth's comprehensive governmental financial activity. The five year trend of

operations, on a GAAP basis, is summarized in the following table.

Within the Capital Projects Funds component of the Governmental total, the Commonwealth issued approximately \$200 million more in project financing in early FY97 instead of late FY96. Had such capital project financing been issued in FY96, the Governmental Funds positive fund balance would have increased by an equivalent amount.

### Governmental Fund Operations (Amounts in millions)

	FY92	FY93 <sup>(1)</sup>	FY94	FY95	FY96
Beginning fund deficits.....	\$ (764.3)	\$ (416.8)	\$ (478.3)	\$ (273.7)	\$ (16.3)
Equity transfer .....	-	-	-	15.5	-
Restated beginning balance.....	(764.3)	(416.8)	(478.3)	(258.2)	(16.3)
Revenues and other financing sources.....	20,795.5	22,380.3	23,226.0	24,216.4	25,102.3
Expenditures and other financing uses.....	20,278.9	22,441.8	23,021.4	23,974.5	24,441.4
Excess (deficiency).....	516.6	(61.5)	204.6	241.9	660.9
Ending fund balances (deficits).....	\$ (247.7)	\$ (478.3)	\$ (273.7)	\$ (16.3)	\$ 644.6

(1) As restated to reflect discrete presentation of the University and College Fund.

## INTERNAL SERVICE FUNDS

In FY95, consistent with adoption of GASB statement No. 10 "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues", the Commonwealth established for GAAP reporting purposes three Internal Service Funds. These funds account for the operations of the State Employees Workers' Compensation Program, a special workers compensation program for the Central Artery/Third Harbor Tunnel Project, and for the health insurance programs administered by the Group Insurance Commission. These funds have not been created and are not reported on the statutory basis of accounting. The adjusting accounting entities to report these "GAAP only" Funds represent another difference from the statutory basis.

The Commonwealth self-insures for the State Employees Workers' Compensation Program. This program was administered by the Public Employee

Retirement Administration (PERA) through FY96. Inflows to the program are amounts charged to state departments; outflows are expenses for claims and settlements, and accrued expenses for claims which will be paid in the future. The traditional policy has been to set chargebacks equivalent to claims paid, typically referred to as a "pay as you go" approach. As a result, an unfunded liability of \$249.7 million has accumulated. The Commonwealth should consider a plan to increase annual chargebacks, thus eventually funding such liability.

In regard to the Central Artery/Tunnel Project, the State Executive Office of Transportation and Construction, with the approval of the U.S. Department of Transportation, has created a special workers compensation program to cover all participants (including employees of contractors) on the project. In this arrangement, annual premiums and investment earnings are accumulated by the insurance carrier to fund current and future claims. This approach is expected to diminish this potentially expensive

component of the large, multi-year construction project. With three years experience, it is evident that amounts contributed to the program significantly exceed the expectations of current and future benefits. With this situation (the opposite of the State Employees Workers' Compensation Program), the Executive Office of Transportation and Construction should consider a plan to decrease annual premiums, and thus lower the accumulated balance, on a go-forward basis. The respective contributions of both state and federal governments must be considered in any change to this program.

The Group Insurance Commission manages the health insurance program for state employees, retirees, and their beneficiaries. Inflows to the program are amounts contributed by individuals, participant organizations, or by the Commonwealth; and outflows are expenses for claims, plus an amount of accrued expenses for claims incurred but not reported. The accumulated balance, while a small deficit, is not material to the size of the program, suggesting that symmetry of inflows to outflows is reasonable and change is not warranted.

The operations of the Internal Service Funds is depicted on the following chart.

### Internal Service Fund Operations (Amounts in millions)

	Beginning Retained Earnings	Premiums Less Claims and Judgements	Other Revenues (Changes)	Ending Retained Earnings
Employees Workers Compensation.....	\$ (270.8)	\$ -	\$ 21.1	\$ (249.7)
Central Artery Workers Compensation.....	97.4	19.7	12.7	129.8
Employees Group Health Insurance.....	(50.0)	0.2	18.7	(31.1)
Total.....	<u>\$ (223.4)</u>	<u>\$ 19.9</u>	<u>\$ 52.5</u>	<u>\$ (151.0)</u>

## FIDUCIARY FUND OPERATIONS

The Fiduciary Fund Type reports funds where the Commonwealth is acting as an agent or steward for funds which relate to another party. The Fiduciary Fund Type includes the Expendable Trust, Nonexpendable Trust, Pension Trust, and Agency Funds.

The Nonexpendable Trusts account for assets held with restrictions and the Agency funds account for assets managed temporarily on behalf of other parties. The amount of such assets managed by the Commonwealth increased by \$674.3 million during FY96 to \$6.2 billion.

The Expendable Trusts ended FY96 with a fund balance of \$1.2 billion composed of a balance of \$112.7 million in Expendable Trusts and \$1,043.0 million in the Unemployment Compensation Trust Fund.

The Commonwealth is responsible for the payment of pension benefits to its employees and to the teachers of

the cities, towns, and regional school districts. It manages the operations of both the State Employees Retirement System (SERS) and Teachers Retirement System (TRS), and reports the results of operations and net assets available to fund pension benefit as Pension Trust funds. Pursuant to the pension reform law, effective in FY88, the Commonwealth is funding its pension liabilities on a 40-year schedule. It is the responsibility of the Public Employee Retirement Administration (PERA) to complete actuarial updates for the funding schedule. In FY97, PERA was reorganized in statute to the Public Employee Retirement Administration Commission (PERAC), but retains the responsibility for actuarial updates. Also in FY97, the investment vehicles for all pension funds (state employee and employer amounts, and teacher employee and employer amounts) were unified into a single investment entity, under the management of the Pension Reserve Investment Management Board (PRIM). The actuarial report for SERS, TRS, and for the State-Boston Retirement System was published by PERA as of January 1, 1996.

The Commonwealth adopted the provisions of GASB statement Nos. 25 and 27 in FY96 which changed the measurement focus of funding progress. The following table presents the funding progress (amounts in millions) applied under the prior standards while the funding progress under the new standards are disclosed in footnote 10.

	<u>FY92</u>	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>	<u>FY96</u>
Unfunded Actuarial Liability.....	\$ 7,815	\$ 8,892	\$ 8,469	\$ 7,301	\$ 6,722
Funded Ratio.....	55.7%	54.3%	59.0%	62.8%	69.7%

The following table presents a five-year trend analysis of the Pension Trust Funds operations:

**Pension Trust Funds Operations**  
(Amounts in millions)

	<u>FY92</u>	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>	<u>FY96</u>
Beginning fund balances.....	\$ 8,373.0	\$ 9,648.6	\$ 11,121.1	\$ 11,563.1	\$ 13,483.2
Revenues.....	2,104.1	2,374.2	1,376.3	2,902.1	3,560.6
Expenses.....	828.5	901.7	934.3	982.0	1,087.6
Excess.....	1,275.6	1,472.5	442.0	1,920.1	2,473.0
Ending fund balances.....	<u>\$ 9,648.6</u>	<u>\$ 11,121.1</u>	<u>\$ 11,563.1</u>	<u>\$ 13,483.2</u>	<u>\$ 15,956.2</u>

**UNIVERSITY AND COLLEGE FUND TYPE**

Since FY93 the CAFR has presented the University and College system in accordance with the AICPA Industry Audit Guide, "Audits of Colleges and Universities." This presentation combines financial activity from all fund types for:

- the University of Massachusetts, including its campuses at Amherst, Boston, Dartmouth, Lowell, Worcester Medical School, and the Teaching Hospital, Group Practice and Building Authorities,

- the State College system of nine state colleges, which provide four-year post-secondary education, and the State College Building Authority, and
- the Community College system of fifteen community colleges which provide two-year post-secondary education programs.

The University and College Fund Type reports a positive GAAP fund balance. Approximately \$2.2 billion of this fund balance is restricted or designated in plant funds, endowment funds, or other purposes.

**University and College Fund Type Operations**  
(Amounts in millions)

	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>	<u>FY96</u>
Beginning fund balances.....	\$ 1,991.6	\$ 2,010.4	\$ 2,034.9	\$ 2,091.2
Revenues and other additions.....	1,329.2	1,449.5	1,536.7	1,740.1
Expenditures and other deductions.....	1,881.3	2,006.4	2,082.0	2,187.2
Net transfers, including state appropriations.....	570.9	581.4	601.6	636.2
Net increase.....	<u>18.8</u>	<u>24.5</u>	<u>56.3</u>	<u>189.1</u>
Ending fund balances.....	<u>\$ 2,010.4</u>	<u>\$ 2,034.9</u>	<u>\$ 2,091.2</u>	<u>\$ 2,280.3</u>

In FY96, nine of these entities are commended for producing stand alone audited financial reports. This list includes Holyoke Community College, Massasoit Community College, Springfield Technical Community College, Bridgewater State College, the Massachusetts College of Art, Framingham State College, Worcester State College, the State College Building Authority, and all campuses and component units of the University of Massachusetts. Each of these schools has demonstrated accountability to its trustees, the Governor and Legislature, and to all concerned parties with audited financial statements prepared in accordance with GAAP. For several years both the Comptroller's Office and the Board of Education (previously the Higher Educational Coordinating Council) have encouraged all schools as a matter of

policy to commit the requisite resources and effort to produce stand alone audited financial statements. The University of Massachusetts is an excellent example of the successful implementation of this policy, as it reported very favorable financial performance in FY96. In the FY97 appropriation act the Legislature authorized the institutions of higher education to create component units, called Foundations, to assist in fund raising for public education. As part of this authorization, the legislation requires each foundation to produce audited financial statements. It would be reasonable to extend the statutory requirement for stand-alone financial statement audits in conformity with GAAP beyond the Foundations to the respective institutions.

## COMPONENT UNITS

The Commonwealth's relationship to the independent public authorities, reported as Component Units, is based on statute and contracts between the Commonwealth and these entities.

### Component Units Operations

(Amounts in millions)

	Beginning Retained Earnings	Operating Gain/ (Loss)	Subsidy	Other Changes	Ending Retained Earnings
Massachusetts Bay Transportation Authority.....	\$ (212)	\$ (495)	\$ 564	\$ (61)	\$ (204)
Massachusetts Turnpike Authority.....	346	2	-	9	357
Regional Transit Authorities.....	2	(79)	57	22	2
Massachusetts Water Pollution Abatement Trust.....	17	(6)	3	16	30
Massachusetts Convention Center Authority.....	(2)	(12)	18	(4)	-
Bay State Skills Corporation.....	1	(12)	5	7	1
Government Land Bank.....	28	(7)	6	4	31
Massachusetts Community Development Finance Agency.....	1	-	1	-	2
Massachusetts Technology Park Corporation.....	20	(2)	1	-	19
Community Economic Development Assistance Corporation.....	35	2	-	2	39
Massachusetts Corporation for Educational Telecommunication....	4	(8)	5	3	4
Massachusetts Industrial Service Program.....	20	(33)	1	19	7
Massachusetts Housing Partnership.....	15	2	1	(4)	14
Massachusetts Zoological Corporation.....	-	(3)	3	-	-
Massachusetts International Trade Council.....	-	(1)	1	-	-
Total.....	<u>\$ 275</u>	<u>\$ (652)</u>	<u>\$ 666</u>	<u>\$ 13</u>	<u>\$ 302</u>

The Massachusetts Turnpike Authority (MTA) is included in the reporting entity and the above table for the first time in FY96, due to a change in the financial relationship. This changed status engendered significant work at the MTA to produce GAAP financial statements, and they are commended for this successful accomplishment. In contrast, the Massachusetts Zoological Corporation, while not material to the Commonwealth as a whole, is an area of concern since they failed to produce GAAP statements for the second consecutive year.

## **INDEPENDENT AUDIT**

The firm of Deloitte & Touche LLP, together with subcontractors Daniel Dennis & Company, Margaret Carr, CPA and Susan Perna-Damon, CPA, and assisted by the Office of the State Auditor, have performed an independent audit of the Commonwealth's general purpose financial statements for the fiscal year ended June 30, 1996. We express our thanks to the staff of the respective firms for their professionalism, advice and counsel. FY96 marks the eleventh consecutive year that the financial statements have been reported upon by independent auditors. Their report is presented in the Financial Section.

## **INTERNAL CONTROL ENVIRONMENT**

Massachusetts law, Chapter 647 of the Acts of 1989, places authority and responsibility for internal controls with the head of each executive department, constitutional office, and branch of government. The Office of the Comptroller issues internal control guidelines and the Office of the State Auditor may investigate departments with risk of internal control weaknesses. These two offices have continued to deliver joint training sessions for department managers regarding their responsibility for internal control in the Commonwealth's highly computerized environment.

Absolute internal control assurance is prohibitively expensive. Using risk assessment criteria set forth in the guidelines and stressed in the training, the objectives of the Commonwealth's internal control structure are to provide management and the public with reasonable assurance that internal control systems do not have material weaknesses. The reader is referred to the separately published Commonwealth Single Audit Reports for additional information on internal controls.

## **REPORTING ENTITY**

The financial statements incorporate the fiscal activities of 148 departments, agencies, boards, commissions, institutions of higher education, the judicial and legislative branches of government, and constitutional offices. These departments record their daily financial operations in the state accounting system called the Massachusetts Management Accounting and Reporting System (MMARS), operated by the Office of the Comptroller.

In addition, the financial statements include independent public authorities, and the State Employees' and Teachers' Retirement Systems. These component units meet the GAAP criteria for inclusion in the reporting entity, which are further described in Note 1 to the general purpose financial statements.

## **ACCOUNTING SYSTEM AND BUDGETARY CONTROL**

MMARS is the computerized, statewide accounting system used by all departments to control and account for their financial activity under the statutory basis of accounting. The financial operations of the authorities and certain non-appropriated higher education funds are accounted for through their own independent accounting systems.

MMARS is designed to satisfy all requirements of the Commonwealth's statutory basis of accounting and financial reporting. Any additional information needed to prepare financial statements according to GAAP is provided through a combination of MMARS system-generated data, information compiled by departments, and the submission of audited financial statements from certain independent authorities.

Note 2 to the general purpose financial statements provides a reconciliation between the General and Budgeted Special Revenue Funds on a statutory basis and the GAAP basis presented in the general purpose financial statements.

## **CASH AND INVESTMENTS**

Cash and investments are controlled by the State Treasurer. Each department transmits all cash receipts to the Treasurer's Office. Weekly and daily warrants for disbursements are prepared by the Comptroller, and reviewed and approved by the Governor's Council;



disbursements are issued by the Treasurer. A major project is underway to streamline the banking and disbursement process, and maximize use of electronic funds transfer.

A system of bank depository and disbursement accounts and lockboxes is employed by the Treasurer's Office to maximize daily cash balances. The Treasurer manages these cash balances in pooled investment funds to optimize interest earnings. The Treasurer's Office invests cash from these general accounts in short-term securities and other investments. A discussion of cash and investments is presented in Note 3 to the general purpose financial statements.

The Treasurer is also responsible for quarterly cash flow plans, weekly variance reports, and, jointly with the Executive Office for Administration and Finance, annual and quarterly cash management plans. Taxes and non-tax inflows, warrants, other outflows, and short and long-term borrowings are monitored against these plans.

FY96 is the third year of the Commonwealth's implementation of the U.S. Cash Management Improvement Act (CMIA). The CMIA requires the states to measure interest income on federal funds drawn from the U.S. Treasury prior to disbursement, and for the U.S. Treasury to measure interest income on funds drawn down subsequent to disbursement. A settlement of interest due to or due from the state and federal government is computed. For FY96, the net settlement is in favor of the Commonwealth.

## DEBT

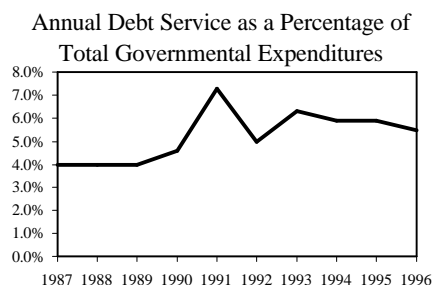
The Commonwealth funds its capital appropriations by authorizing the issuance of long-term bonds. The following table sets forth the trend of the Commonwealth's tax-supported long-term indebtedness for the last five years:

### Long-Term Debt

(Amounts in billions)

Fiscal Year	Authorized - Unissued	Principal Amount of Outstanding Long-Term Debt
1996	\$ 8.2	\$ 10.1
1995	5.9	9.6
1994	4.5	9.4
1993	4.6	9.2
1992	4.9	8.6

To limit the Commonwealth debt burden, and control the degree to which debt service creates pressure on the operating budget, the Administration has implemented a five-year capital spending plan. This administrative policy has been in effect for several years, and the effect of debt service on the operating budget is depicted on the following table.



As authorized by state finance law, the State Treasurer may utilize short-term borrowing to support governmental cash flow. All such borrowings were repaid before the end of the fiscal year.

Other debt consists of certificates of participation and capital lease agreements. Such financing arrangements are used to acquire capital assets, for example computer equipment and motor vehicles. The Commonwealth continued to utilize this form of financing in FY96.

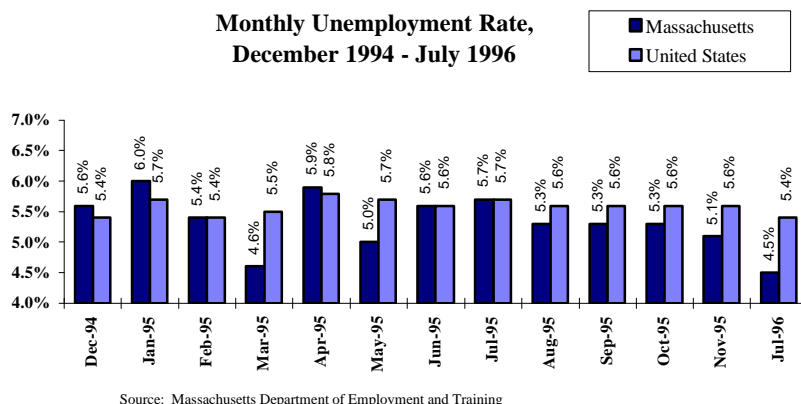
Additional information on Commonwealth debt, including guaranteed debt of independent public authorities, is presented in Notes 7, 8, and 12 to the general purpose financial statements.

## RISK FINANCING

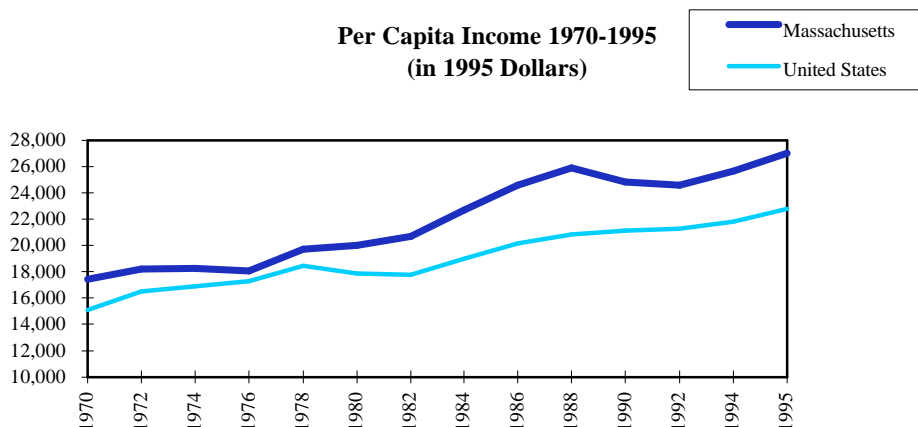
The Commonwealth assumes the risk of loss for property damage and personal injury, breach of contract, condemnation proceedings, and other alleged violations of law, and is defended by the Attorney General's Office in such cases. In FY96, approximately \$20.0 million was expended to resolve such claims in special and existing appropriations. Based on the Attorney General's evaluation of cases in which it is probable that a judgment will be rendered against the Commonwealth, and a loss incurred, an additional \$53.1 million has been accrued in the Governmental Funds at June 30, 1996.

## ECONOMIC AND FINANCIAL PROSPECTS

Massachusetts employment grew 2.2% in 1994 and 0.9% in 1995. The Massachusetts unemployment rate, currently at 4.5%, remains below the national rate of 5.4%.



Commonwealth per capita income continues to outpace the nation as shown below.



The Commonwealth of Massachusetts, with an international reputation for medical, cultural, historical, and educational institutions, is the economic and educational hub of New England. The Commonwealth's economy remains diversified but its strongest component is its knowledge-based technology and service industries.

Massachusetts' infrastructure provides strong support for this knowledge-based economy. There are over 120 colleges and universities located in Massachusetts, and 27.2% of the residents over age 25 have earned bachelor's degrees, compared to 20.3% for the United States as a whole.

Our capital, Boston, has 25 hospitals and three medical schools. Tourism is a significant component of the economy. The Massachusetts Office of Travel and Tourism estimates that over 28.0 million visitors spent over \$9.2 billion in the Commonwealth in 1994. The Commonwealth ranked twelfth among states in exports with \$15.1 billion in 1995.

A continued low rate of inflation is expected to keep wage growth low and allow for slow-paced positive growth in the Massachusetts economy.

The Commonwealth's FY97 budget forecast is consistent with the economic trends presented above. Budgeted revenues and other sources, as estimated by the Executive Office for Administration and Finance, are currently projected at approximately \$17.2 billion. The estimate assumes tax revenues to be approximately \$12.1 billion, or 0.6% above FY96 actual collections.

The Commonwealth's total budgeted expenditures and other uses in FY97 are projected at \$17.7 billion. This estimate assumes the spending in the Commonwealth's seven major programs (Local Aid, Medicaid, Employee Health Insurance, Public Assistance, Debt Service, Pensions and Subsidies to Transit Authorities), which comprise over 88.4% of budgetary spending, will increase by 4.3% over FY96.

The FY97 opening fund balance on a statutory basis is \$1,172.4 million. If the FY97 forecast is realized, the ending fund balance will be approximately \$704.7 million. It is noteworthy that, of the \$704.7 million, approximately \$543.3 million is projected to be reserved in the Commonwealth's Stabilization Fund. In this forecast, the Commonwealth has continued a conservative approach. As in past years, ending fund balances may be higher due to this conservative approach to forecasting.

The Administration will soon be engaged in an extensive mid-year review of this estimate. The Governor will release his recommended budget for FY98 in late January, at which time the FY97 forecast may be revised.

## **SIGNIFICANT ACCOMPLISHMENTS**

In FY96, there were a number of significant public policy accomplishments and, on a more operational level, improvements that demonstrate accountability and financial management.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Commonwealth for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 1995. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports. This is the sixth consecutive year that the Commonwealth has received this award.

The non-tax revenue optimization campaign was very successful in FY96. With special authorization in the budget, a task force was comprised of key persons from the Executive Office for Administration and Finance, the Budget Bureau, the Information Technology Division, and the Comptroller's Office. The task force provided leadership and sponsored projects by which outside experts were engaged on a contingent fee basis, and departments optimized various sources of non-tax revenue (such as federal reimbursement) by over \$50 million. After payments to the consultants, and with the participating departments retaining \$5 million in performance incentive funding, the net profit to the General Fund was \$42 million. The initiative is dedicated to optimizing all collection potential within the framework of existing fee structure and program authorizations. The non-tax revenue optimization campaign will continue in FY97.

A large number of projects to enhance or re-engineer business processes with new technology have been performed. Such projects relate to an array of Commonwealth activities, including automation of welfare eligibility determination, management of cases in the legal system, creating a new statewide client server infrastructure, and significant changes to the Commonwealth's administrative and fiscal systems.

Examples of projects from the domain of financial accounting include: major streamlining of the Commonwealth's cash deposit and non-tax revenue systems; automation of the previously manual functions to exchange cash with the federal government; re-engineering the Commonwealth disbursement practices to the model of electronic commerce, including electronic data interchange, electronic funds transfer, and electronic benefits transfer; and creating a data warehouse to make the wealth of data emanating from transaction processing systems accessible and available to knowledge workers via query systems controlled by desktop computers.

Under the leadership of the Information Technology Division, several departments across the branches of government are collaborating in joint ventures to leverage resources in these projects. This approach is yielding significant results both in terms of shared functionality and interoperable systems, and increased purchasing power through joint procurements. Exciting partnerships with internal Commonwealth departments and private sector business partners have developed. Several of these projects have received national recognition and awards.

In early FY97 the Governor and Legislature enacted a second Information Technology Capital Outlay. This provides the funding and management framework for another series of projects that will exploit new technologies to improve the way the Commonwealth conducts its business. With this innovative authorization technique and through its array of projects, the Commonwealth is again the focus of attention by other states, the U.S. government, and the private sector. The prospects for future success are outstanding.

## **RECOMMENDATIONS AND CONCLUSIONS**

The Office of the Comptroller has a unique perspective on state finance based on insights gained through control of day-to-day operations and experience with GAAP. With this background, we take this opportunity to make proposals intended to strengthen state finance.

The Commonwealth should enact a program to fund the liability for the State Employees Workers' Compensation Program as it is incurred and amortize the accumulated unfunded liability of \$249.7 million. This amount did not materialize in a single year and a multi-year funding schedule is recommended. Options to furnish the necessary funding include a "surcharge" to the current statutory chargeback to state agencies, special lump sum appropriations, a redirection of investment earnings, and other actions. Accumulating assets to satisfy the current unfunded liability will be another demonstration of interperiod equity and sound financial management. In contrast, for the special workers compensation program for the Central Artery/Tunnel Project, the Commonwealth should consider decreasing annual contributions. In this instance it appears the amount accumulated for current and future claims is more than adequate. Since both federal and state government contribute to the program, any change to annual contributions must be structured accordingly.

Regarding the institutions of higher education, the time has come for each school to produce audited stand-alone financial statements in conformity with generally accepted accounting principles. While many schools have moved into this practice of their own volition, and

others are currently in the preparation process, it is appropriate to make this a statutory requirement. The Comptroller's Office will continue to provide guidance and support to such an effort.

Consistent with the prior recommendations, the Office of the Comptroller believes the Commonwealth's current fund structure should be streamlined. The proliferation of budgeted Special Revenue Funds has fractured, not strengthened, the budget process. As special interest groups have enjoyed political success in carving out dedicated revenues and removing operations from the general budget, the capacity for centralized planning and control has diminished. The numerous non-budgeted Special Revenue Funds and Capital Projects Funds further complicate efforts to obtain a comprehensive view of state finance.

Legislation should be enacted to simplify the fund structure, reduce the number of funds to a more manageable number, and eliminate all fund deficits. The current practices of "fund splitting" appropriations and interfund transfers should be eliminated.

The definition of a balanced budget, and the terms and conditions for deposits into the Stabilization Fund, should be simplified. This would result in a more coherent and understandable picture of the Commonwealth's Governmental Funds financial activity.

The Commonwealth has a tremendous opportunity to employ new technologies to improve its programmatic, financial, and administrative operations. In FY93 the Governor proposed and the Legislature enacted the first Information Technology Capital Outlay. In FY97, the Governor and Legislature enacted a second Information Technology Capital Outlay. With this funding the opportunity exists to re-engineer old business practices and engage new technology. An unprecedented interdepartmental coalition under the leadership of the Commonwealth's Chief Information Technology Officer creates an exciting opportunity to make strategic investments that will position the Commonwealth successfully into the next century.

In conclusion, this report represents the continued commitment of the Office of the Comptroller to promote quality in the Commonwealth's financial management. I express my sincere appreciation to the dedicated professionals in the Comptroller's Office, BJ Trivedi and the staff of the Financial Reporting Bureau, Mr. James Powers, CPA, and other state departments and organizations whose efforts are reflected in this report.

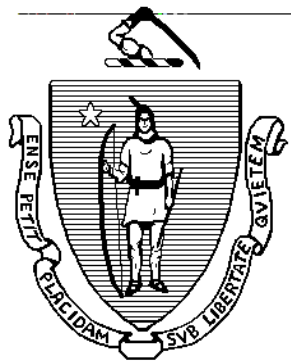
In addition, the work of the several project teams to implement the Information Technology projects mentioned above is especially noteworthy. They are launched on projects that will create enduring value not only to Massachusetts, but to other states and governments throughout the nation. They exemplify the cutting edge of innovation, and the citizens of the Commonwealth are well served by professionals of their caliber.

The Office of the Comptroller transmits the Comprehensive Annual Financial Report for FY96 in accordance with Section 12 of Chapter 7A of the General Laws.

Respectfully transmitted,

*William Kilmartin*

William Kilmartin  
Comptroller



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## **Principal State Officials**

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### **CONSTITUTIONAL OFFICERS**

William F. Weld  
*Governor*

Argeo Paul Cellucci  
*Lieutenant Governor*

William F. Galvin  
*Secretary of State*

L. Scott Harshbarger  
*Attorney General*

Joseph D. Malone  
*Treasurer and Receiver-General*

A. Joseph DeNucci  
*Auditor*

### **LEGISLATIVE OFFICERS**

Thomas F. Birmingham  
*President of the Senate*

Thomas M. Finneran  
*Speaker of the House*

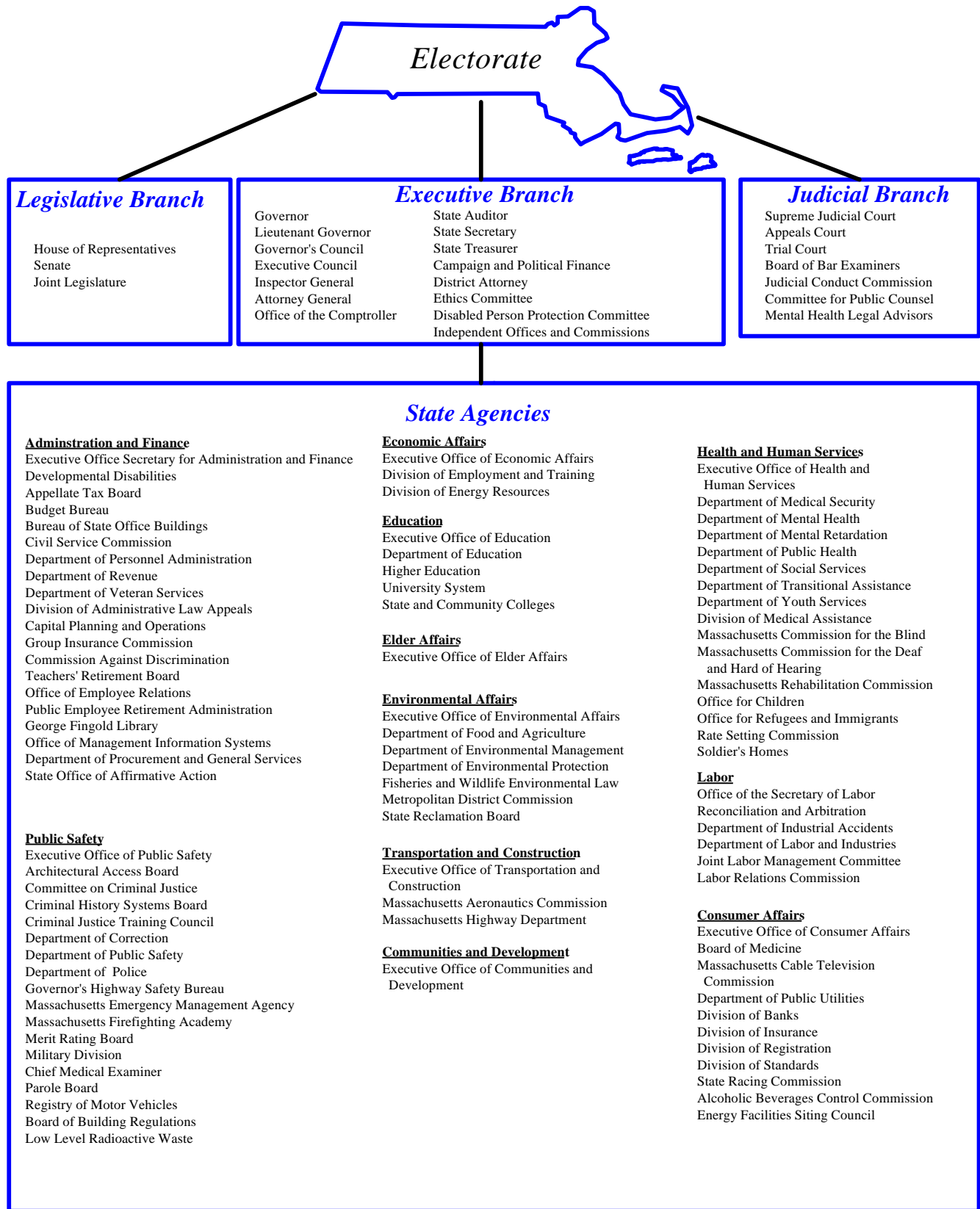
### **JUDICIAL OFFICERS**

Herbert P. Wilkins  
*Chief Justice, Supreme Judicial Court*

Joseph P. Warner  
*Chief Justice, Appeals Court*

John J. Irwin  
*Chief Justice for Administration and Management, Trial Court*

## Organization Chart





## Acknowledgements

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Padmanabh Patel  
*Intern*

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*Layout and Design*  
*Director Resource Management*

James Powers, CPA  
*Special Projects*

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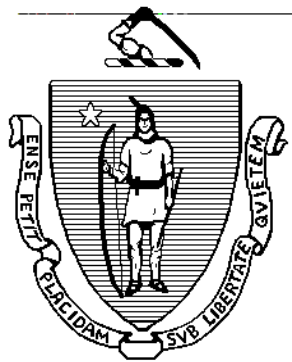
For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 1995

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



*Arthur R. Lynch*  
President

*Jeffrey L. Essler*  
Executive Director



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